IN THE

Supreme Court of the United States

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SEBELIUS, SECRETARY OF HEALTH & HUMAN SERVICES, *et al.*,

Petitioners,

v.

HOBBY LOBBY STORES, INC., *et al.*,

Respondents.

CONESTOGA WOOD SPECIALTIES CORP., *et al.*,

Petitioners,

v.

SEBELIUS, SECRETARY OF HEALTH & HUMAN SERVICES, *et al.*,

Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURTS OF APPEALS FOR THE TENTH AND THIRD CIRCUITS

BRIEF OF *AMICI CURIAE* FREEDOM X, STEVEN J. WILLIS, KRISTIN BALDING GUTTING AND DANIEL D. BARNHIZER IN SUPPORT OF RESPONDENTS IN NO. 13-354 AND PETITIONERS IN NO. 13-356

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ISSUES PRESENTED

1. Whether the Court should make a distinction between C Corporations and S Corporations when it determines the religious rights of corporations.

2. Whether the Third and Tenth Circuits' imprecise or improper use of the terms "for profit" and "non profit" led to flawed legal analyses that unconstitutionally create two unequal tiers of First Amendment religious rights based solely upon financial considerations.

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INTEREST OF AMICI CURIAE[1]

Freedom X is a public interest law firm dedicated to protecting the freedom of religious, political and intellectual expression. Freedom X and its donors and supporters are gravely concerned that this case may result in subjecting businesses to the imposition of compulsory rules that violate the consciences and religious values of their shareholders and principals, thus depriving business owners of their fundamental right to religious liberty by virtue of the taxable corporate form they elect.

Steven J. Willis is Professor of Law at the University of Florida College of Law. For thirty-three years, he has taught courses in charitable law, tax law, family law, accounting, and finance. He has written and lectured extensively on the law of charities, as well as on the inter-relationship of tax law, business entities, and family law. Professor Willis believes courts are erroneously treating S corporations as "distinct and separate" from their shareholders in a way that denies both the corporations' and shareholders' religious rights. Professor Willis is also concerned that courts have confusingly used the terms "for profit" and "non profit." *Amici Curiae* gratefully acknowledge the work of Steven J. Willis, the principal author of this brief.

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[1] All the parties other than Hobby Lobby Stores, Inc., have filed blanket waivers with the clerk of the court. The consent of Hobby Lobby is attached hereto. As required by Rule 37.6, *amici* state that no counsel for a party authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than amici curiae, their members, or their counsel made a monetary contribution to its preparation or submission.

Kristin Balding Gutting is an Associate Professor of Law at the Charleston School of Law. For eight years, she has taught courses in the area of tax law, including tax procedure, partnership taxation, and federal income taxation. She has written and lectured in the areas of partnership taxation, tax procedure, tax ethics, and income taxation. Professor Gutting believes courts are erroneously treating S corporations as "distinct and separate" from their shareholders in a way that denies both the corporations' and shareholders' religious rights. Professor Gutting is also concerned that courts have confusingly used the terms "for profit" and "non profit."

Daniel D. Barnhizer is a Professor of Law and the Bradford Stone Faculty Scholar at Michigan State University College of Law, where he also serves as the faculty advisor to the Christian Legal Society. Since 2001, he has taught in the areas of commercial and contract law, corporate and business organization law, as well as courses on jurisprudence and the Rule of Law. He researches and writes on topics relating to contract theory and the Rule of Law. Professor Barnhizer believes courts are erroneously treating S corporations as "distinct and separate" from their shareholders in a way that denies both the corporations' and shareholders' religious rights. Professor Barnhizer is also concerned that courts have confusingly used the terms "for profit" and "non profit."

SUMMARY OF ARGUMENT

The Third Circuit in *Conestoga* over-broadly described a corporation as "distinct and separate"[2] from its shareholders. It also broadly described corporations as "artificial beings."[3] The court used that separateness and artificiality to deny corporate religious rights, to deny corporate standing to assert shareholder rights, and to deny shareholder standing to assert their own rights.

The Third Circuit additionally failed to distinguish S corporations from C corporations. S corporations—which include Hobby Lobby, Mardel, and Conestoga—are mostly one and the same with their owners, not "distinct and separate." This close identity supports corporate standing to assert shareholder rights as well as shareholder standing. Tax law treats S corporation shareholders as the true actors in the commercial activities they collectively conduct.

The Third Circuit was wrong to deny religious rights to Conestoga. The court relied on Conestoga being an "artificial being" but ignored how law so often ignores that artificiality. It thus denied religious rights to an entity that the law generally treats as one and the same with its shareholders.

Additionally, both the Third Circuit and the Tenth Circuit confusingly used the term "for profit."

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[2] *Conestoga Wood Specialties Corp. v. Sec'y of U.S. Dep't of Health & Human Servs.*, 724 F.3d 377, 388 (3d Cir. 2013) *cert. granted*, 134 S. Ct. 678 (U.S. 2013) (quoting *Barium Steel Corp. v. Wiley*, 108 A.2d 336, 341 (Pa. 1954)).

[3] *Conestoga*, 724 F.3d at 383, 385.

First, both courts used the term "for profit" [4] to describe the litigants without clearly defining how a "for profit" entity is distinguishable from a "non profit" entity. Second, the Third Circuit then used the term "for profit" as a factor in denying religious rights to Conestoga. This use suggests the court would apply a different rule if Conestoga were "non profit" or "not for profit"; however, the Court provided no clear insight into how those categories differ. Because those terms are not terms of art in the fields of corporate and charitable law, any rules or distinctions using them will be unclear. This Court should define such terms or should use terminology more suited to the legal areas involved.

Third, the Third Circuit's use of the term "for profit" assumes the ultimate fact at issue: whether Conestoga is organized "for" general purposes that include religious purposes, or whether it exists merely "for" the purpose of making profits.

ARGUMENT

This matter arises under I.R.C. §4980D and involves corporate and shareholder religious rights. At least forty cases, including the two before the Court, have struggled with corporate religious rights;[5]

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[4] *Id.* at 381 (three times), 382, 383 (twice), 384, 385 (six times). The court, including the dissent, uses "for profit" or "for-profit" 91 times.

[5] *See* Steven J. Willis, *Corporations, Taxes, and Religion: The Hobby Lobby and Conestoga Contraceptive Cases*, 65 S.C. L. REV. 1, 3 & n.2 & n. 5 (2013) (listing and generally discussing the 40 cases) but only briefly discussing *Gilardi v. United States HHS*, 733 F.3d 1208, 1224-25 (D.C. Cir. 2013), which arose just before the article went to press). *See Gilardi* at 1224-25, Randolph, J., concurring in part and concurring in the judgment. Judge

yet all have misused the vocabulary of tax and corporate law.[6] In addition, some—including the Third Circuit—have failed to apply critical distinctions between and among types of corporations.

This brief addresses two areas in prior case decisions where misuse of terms and misunderstanding of corporate status have produced inaccurate and ultimately unjust results. Here those results impinge upon and restrict the fundamental right of religious expression. First, the Third Circuit mistakenly stressed that corporations are always "distinct and separate" from their owners. The Court failed to distinguish S corporations, which closely identify with shareholders, from C corporations, which *are* "distinct and separate" from their shareholders.

Second, both the Third and Tenth Circuits adopted the terms "not for profit" and "non profit" as if they are interchangeable and share a particular meaning, but without adequately defining either term. However this Court decides these cases, it should clarify the terms so that readers, including those who practice or teach corporate and tax exempt law, properly understand the holding.

Randolph argued: "It would be incongruous to emphasize the corporate veil in rigid form for RFRA purposes while disregarding it for tax purposes under subchapter S. This inference is particularly compelling because both subchapter S and the 'tax' that enforces the contraceptive mandate are part of the Internal Revenue Code. *I.R.C. §4980D.*"

[6] *See id.* at 61-70 and the authorities cited therein.

I. The Third Circuit Mistakenly Focused On The Corporate Entity As "Distinct And Separate" From Its Owners.

The Third Circuit *Conestoga* opinion stressed how corporations and shareholders are "distinct and separate"[7] under general corporate principles.[8] It used that separateness to deny Conestoga religious rights under the First Amendment, under the Religious Freedom Restoration Act (42 U.S.C. § 2000bb), or through the shareholders via prudential/associational standing.[9]

Although many corporations are indeed distinct and separate from their owners, an important category is not: S corporations.[10] Hobby Lobby,[11] Mardel,[12] and Conestoga[13] each have elected S status. As explained below, because they are S corporations, each is effectively one and the same with their shareholders, a point ignored by the Third Circuit.

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[7] *Conestoga*, 724 F.3d at 388.

[8] *Id.* at 387.

[9] *Id.* at 385, 388, and 409.

[10] I.R.C. §1361. Congress created the S corporation status with closely held corporations in mind. I.R.C. §1361 refers to them as "small business corporations" and requires they have no more than 100 shareholders. It is an alternative to partnership status, which is another type of "pass thru" entity. Owners who decide to elect S status do not typically choose between C status and S; instead, they choose between partnership status and S corporation status.

[11] *Hobby Lobby v. Sebelius*, Appellant's Br. at 50, n. 23 (Doc. No. 01018999833 02/11/2013).

[12] *Id.*

[13] Conestoga Cert. Br. at 28.

For tax purposes, corporations fit into two main categories: C and S. C corporations are taxpayers.[14] They report income, deductions, and credits on their own tax returns [15] and pay tax on the net. Shareholders receive dividends, on which they *also* pay tax. [16] Dividends are treated as "ordinary income."[17] The Third Circuit's focus on corporations being "distinct and separate" logically applies to C corporations, which tend to be large and which tend to have many shareholders. Such large and diverse entities, such as Apple or Microsoft, plausibly have no religious rights: they truly are "artificial beings" with no personality and no close connection to their owners.

In stark contrast, S corporations—such as Hobby Lobby, Mardel and Conestoga—are not taxpayers.[18] For tax purposes, they merely file an information return on which they separately allocate all items of income, deduction, gain, loss, or credit to their various shareholders.[19] The shareholders then report their share of each item on their personal returns and the shareholders pay any resulting tax. The corporation pays no tax. Tax law refers to S

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[14] I.R.C. §11.

[15] C Corporations must file Form1120: U.S. Corporate Income Tax Return.

[16] I.R.C. §61(a)(7).

[17] The Internal Revenue Code does not explicitly define "ordinary income." However, sections 1221-22 and 64 define capital gains in a manner that excludes "dividends." Because dividends are not gains from the sale or exchange of capital assets, they must be ordinary.

[18] I.R.C. §1363(a).

[19] I.R.C. §1366. S Corporations file Forms1120S and Schedule K-1: Shareholder's Share of Income, Deductions, Credits, etc. and Information About the Shareholder (Part II).

corporations as "pass thru"[20] entities because all the various economic activities (income, deduction, gain, loss, and credit) flow or pass through to the shareholders.

Each item of income or deduction even retains its character as it flows through. Character of a tax item involves issues such as whether it is capital, ordinary, passive, active, at-risk, or investment. Items of different character produce substantially different tax results. For example, long-term capital gain income is subject to a lower tax rate than ordinary income; also, "passive" losses are deductible only to the extent of "passive" income.

Tax law *expressly* treats the items as if the shareholders participated directly in the transactions themselves.[21] Thus, for tax purposes, the law does not treat Mardel as if it sold a Bible to a customer; instead, it treats each shareholder as if he or she individually sold a portion of the Bible to the customer.

If Hobby Lobby must pay $10 for a Plan-B pill, tax law treats it as if David Green paid $2.00 of that in the same manner as the entity did (as would each of the other 4 shareholders). Thus, for tax purposes, David Green paid for the abortion. David Green reaps whatever tax benefits flow from the deduction. This has other real tax consequences: the character flows through to Mr. Green as a section 162 trade or

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[20] I.R.C. §1(h)(10)(C).

[21] I.R.C. §1366(b) provides: "The character of any item included in a shareholder's pro rata share under paragraph (1) of subsection (a) shall be determined *as if such item were realized directly* from the source from which realized by the corporation, or incurred *in the same manner as incurred by the corporation.*" (Emphasis added).

business expense for a non-taxable employee fringe benefit. Section 3121 excludes it from employee wages for FICA and thus Mr. Green is not responsible for that. Section 3402 excludes it for withholding; thus Mr. Green has no responsible person liability for that either. This treatment contrasts with other expenses for interest, rent, inventory costs, capital costs, passive activities, capital losses, foreign expenses, and many more, each of which also flows through to Mr. Green as if he incurred them himself, but each of which affects Mr. Green in different ways. That is the essence of an S corporation: for tax purposes (federal and state), the owner is the actor.

Thus when the government argues Mr. Green would not pay for an abortion, it is incorrect at least for tax purposes. At its core, this case is about section 4980D of the Internal Revenue Code; hence, tax purposes would seem paramount.

Because tax law treats the shareholders as the real actors, an S corporation and its shareholders are not "distinct and separate"; instead, they are *mostly*[22] one and the same. Thus the Third Circuit explained corporate law with far too wide a brush. *Nine times*[23] the court stressed the "distinct" nature of corporations, as if all corporations fit into the same

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[22] Although S corporations remain separate from their shareholders for some purposes, *e.g.*, choice of taxable year or method of accounting, even those aspects do not support the Third Circuit's reasoning; instead, such joint decisions demonstrate the associational nature of S corporations.

[23] The Court uses "distinct" six times and "distinction" three times. *Conestoga*, 724 F.3d at 387 (twice), 388 (three times for distinct and once for distinction) 389 (one mention of each term).

mold. Indeed, most corporations are S corporations,[24] which are effectively partnerships under tax law and which are fundamentally different from widely held, publicly traded corporations. S corporations are not "distinct and separate" from their owners. Tax law mostly ignores their nature as "artificial beings."

The federal tax treatment of Hobby Lobby, Mardel, and Conestoga as essentially one and the same with their owners should be sufficient reason to reject the Third Circuit's overly broad analysis. But a second reason is also very important: state tax law.

Many states impose taxes on corporate income. While the state tax statutes vary, many "piggy-back" on the federal provisions.[25] "Piggy-back" means the state law adopts the federal law as its own. As a result, S corporations often[26] operate as one and the same with their shareholders for state tax purposes. Specifically, both Oklahoma [27] (the state of incorporation for Hobby Lobby and Mardel) and Pennsylvania [28] (the state of incorporation for Conestoga) have "piggy-back" statutes for S corporations. As a result, both effectively ignore the separate entity status for state tax purposes.

Together, federal and state tax law present a powerful reason to view Hobby Lobby, Mardel, and Conestoga as having very close identity with their shareholders. That close identity supports

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[24] James S. Eustice & Joel D. Kuntz, *Federal Income Taxation of S Corporations* ¶ 1.01 (2014).

[25] *Id.* at ¶ 2.03(3)(e)

[26] This is particularly true for states with both corporate and individual income taxes.

[27] Okla. Stat. Ann. tit. 68 § 2365 (West 2014).

[28] 72 Pa. Stat. Ann. § 7307.8 (West 2014).

recognizing religious rights either for the entities themselves or through their owners. But, a third important reason exists: family law. In many states, S corporate income also passes through to an owner for purposes of determining alimony, child support and the division of assets.[29]

State family law schemes vary, with many states yet to consider the issue of whether to respect, for family law purposes, an S corporation as distinct from its owners. In those that have, courts may impute undistributed income remaining in the hands of the corporation as if the funds had been distributed.[30] Under such a ruling, an S corporation's

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[29] *E.g.*, *Tuckman v. Tuckman*, 308 Conn. 194, 61 A.3d 449 (2013); *J.S. v. C.C.*, 454 Mass. 652, 912 N.E.2d 933, 940-42 (Mass. 2009); *Zold v. Zold*, 911 So. 2d 1222 (Fla. 2005) (holding that Florida courts must look at the equities involved to determine whether to respect the corporate form of closely-held businesses for purposes of determining income for alimony and child support purposes); *Roberts v. Roberts*, 666 N.W.2d 477 (S.D. 2003); *In re Marriage of Brand*, 44 P.3d 321 (Kan. 2002); *In re Marriage of Perlenfein and Perlenfein*, 848 P.2d 604, 605 (Or. 1993); *In re Farideh & Nasirpour*, 2011 Cal. App. Unpub. LEXIS 9349 at *27; *Tebbe v. Tebbe*, 815 N.E.2d 180 (Ind. App. 2004); *Dagley v. Dagley*, 695 So. 2d 521, 523 (La. App. 1977). *See also Bleth v. Bleth*, 607 N.W.2d 577, 579 (N.D. 2000) (Court may impute income when a shareholder controls his own salary).

[30] *E.g.*, *J.S. v. C.C.*, 912 N.E.2d 933, 940-43 (Mass. 2009) (adopting a case by case method giving trial judges discretion to determine the availability of S corporation funds to shareholders). The Massachusetts court placed the burden of proving the lack of availability on the shareholder. *See also Zold v. Zold*, 911 So. 2d 1222, 1232-33 (Fla. 2005) (refusing to draw a bright-line and permitting trial judges to determine whether undistributed income may be ignored because of a sufficient business purpose or whether to impute it to the shareholder). *Zold* faced a peculiar accounting provision in Florida family law

income becomes a factor for determining child support and alimony, as well as for determining marital or community income in cases involving property division. Thus a shareholder in an S corporation may not always[31] assert his own corporation is distinct and separate from him and thus shield income from child support or alimony obligations. In contrast, a shareholder in a C corporation generally can successfully shield income by retaining it in the corporate name.

This family law analogy is both instructive and critical in the cases before the Court. A central issue, as repeatedly stated by the Third Circuit, is whether corporations are "distinct and separate" from owners. As shown above, the Third Circuit majority concluded they are distinct. Many family law cases have already recognized the important difference between S corporations and C corporations for analyzing that precise issue.[32] Those cases permit trial courts to ignore the "artificiality" of the S corporation and thus to treat corporation actions as shareholder actions. Not only is this an instructive analogy, but it also critically affects the merits before this Court. Shareholders in Conestoga, Hobby Lobby, and Mardel may someday face claims for child support, alimony, or property division. If so, they risk being treated as one and the same with the entities. The Third Circuit's broad brush description of all corporations as

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that generally imputes "paid" items. See the discussion of this peculiar accounting rule in the authorities cited in note 31, *infra*.

[31] *J.S. v. C.C.*, 912 N.E.2d 933, 940-43 (Mass. 2009). As explained by the Massachusetts court, the burden of proof falls on the shareholder to show that S corporation earnings are not available for child support and other family law matters.

[32] *See* the cases cited in note 28, *supra*.

"distinct and separate" from owners is thus seriously flawed: Conestoga shareholders are one and the same with the entity for federal and state tax law and risk being treated as one and the same for family law.

Interestingly, recognition of an S corporation as one and the same with its owners in family law matters has begun to spread quickly across the country.[33] For example, Connecticut first considered the issue in 2013, Massachusetts in 2009, and Florida in 2005, with each deciding to allow judges to ignore the S corporation as a separate entity when the equities support such a decision. The Florida decision, *Zold v. Zold*, 911 So. 2d 1222 (Fla. 2005) specifically addressed the important distinction between S corporations and C corporations. The Court carefully explained the need to draw a line between entities it viewed as separate from owners and those it viewed as essentially the same as owners. As did the later Massachusetts [34] and Connecticut [35] courts, the Florida Supreme Court declined to draw a bright line, recognizing that minority shareholders without power might justifiably consider themselves separate

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[33] *See* Steven Willis, *Family Law Economics, Child Support and Alimony Ruminations on Income: Part One*, 78 FL. BAR. J. 34 (No. 5, May 2004) and Steven Willis, *Family Law Economics, Child Support and Alimony Ruminations on Income: Part Two*, 78 FL. BAR. J. 34 (No. 6, June 2004) (discussing the flow through of income from various types of entities in relation to family law matters, arguing for distinctions between S corporations and C corporations).

[34] *J.S. v. C.C.*, 912 N.E.2d at 662-63.

[35] *Tuckman v. Tuckman*, 308 Conn. at 212.

because they could not force income distribution.[36] That line drawing exercise should be instructive in this matter.

This Court faces the same issue: whether a corporation is distinct and separate from its owners. It should follow the leading family law cases[37] that wisely distinguish S corporations from C corporations.[38]

II. Both the Tenth and Third Circuits Confusingly Used The Terms "For Profit" And "Non Profit" Without Adequately Defining Them.

The Third Circuit repeatedly labeled Conestoga as a "for profit" corporation, which suggests the court would apply a different rule were Conestoga a "non profit" corporation. Similarly, the Tenth Circuit described Hobby Lobby and Mardel as "for profit" corporations. Neither court clearly explained what it meant by "for profit."

However this Court decides these cases, it should use tax and corporate terminology carefully. Many people, including all the litigants, use the terms

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[36] *Zold v. Zold*, 911 So. 2d at 1231-33. The court also permitted shareholders the opportunity to prove a sufficient business purpose for maintaining some funds in the S corporation.

[37] *E.g.*, *Zold v. Zold*, 911 So.2d 1222 (Fla. 2005), *Tuckman v. Tuckman*, 308 Conn. 194 (2013).

[38] Because each of the litigants, Hobby Lobby, Mardel, and Conestoga, has unanimous agreement among its shareholders, this Court need not address the additional issue faced by state family courts: whether to treat S corporations with dissenting minorities differently from those with unanimity.

"for profit" and "non profit" or "not for profit." Unfortunately none define the terms.

Presumably, the courts used "for profit" as a description of a general business entity operating for the benefit of owners.[39] That would distinguish it from a charitable organization, which operates for the benefit of itself and its charitable purpose.[40] The "for profit" terminology, however, is inappropriate. General business corporations certainly may earn profits as defined for tax law or generally accepted accounting principles. But charities may also earn profits as long as they do not "inure to the benefit of private shareholders."[41] The words "non-profit" and "not for profit" do not appear in I.R.C. §501(c)(3) or the corresponding treasury regulations.[42] Indeed, the relevant treasury regulations addressing charities *expressly* permit substantial trades or business activities.[43]

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[39] Black's law dictionary does not define "for profit"; however, it equates a "non-profit" entity with a charity. *Black's Law Dictionary* 147-48 (2d Pocket Ed. 2001).

[40] Per I.R.C. §501(c)(3) charities operate exclusively for one or more listed charitable purposes. Because they have no shareholders, they exist perpetually for their own purposes.

[41] I.R.C. §501(c)(3); Treas. Reg. §1.501(c)(3)-1(c)(2).

[42] The term "for-profit" appears once in an example. Treas. Reg. §1.501(c)(3)-1(d)(1)(ii) Example 3. The term "non profit" appears in I.R.C. §501(c)(4) in relation to social welfare organizations; however, it has no practical significance.

[43] Treas. Reg. §1.501(c)(3)-1(e)(1) provides: "An organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose

If this Court were to draw a distinction between for profit and non-profit businesses, those who practice and teach in the area of charitable law would be hard pressed to explain how the line would be drawn between the two categories. Would a tax-exempt hospital or school that earned profits be "for profit" or would it be "non profit"? Substantively, such an entity would intentionally have profits and thus would be "for profit"; however, one suspects the Third Circuit would classify it as "non-profit" in a more colloquial sense. If the Court draws such a distinction, it should avoid colloquial usage and would be wise to use a more specific term, such as a "charity described in section 501(c)(3)."[44]

The terms *non-profit* and *not-for-profit* are actually state law terms.[45] All states have general business corporation acts. Most have a non-profit or not-for-profit corporation act. Such non-profit corporation acts do not exist to preclude profits; [46]

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of carrying on an unrelated trade or business, as defined in section 513."

[44] The Court, however, should carefully weigh even that distinction, as many charities—such as hospitals and schools—can have substantial profits and thus may have few real differences from a taxable school or hospital other than the inurement of earnings to shareholders.

[45] *See* Darryl Jones, Steven Willis, David Brennen, and Beverly Moran, *The Tax Law of Charities* 2 (West 2007).

[46] *E.g.*, Model Non-Profit Corp Act §3.01 (providing "non-profit" corporations the power to engage in any lawful activity); §3.02 (permitting "non-profit" corporations to operate businesses and other commercial activities); §6.40 (prohibiting the distribution of a "non-profit" corporation's income or profits to members). The model act never defines the term "non-profit," but it permits non-profit corporations to earn profits as long as they do not inure to the benefit of members.

instead, they exist to provide standard provisions desired by most charities.[47]

Importantly, nothing in Oklahoma or Pennsylvania [48] non-profit law actually [49] requires entities organized as such to *be* non-profit. Indeed, Oklahoma does not even have a separate statute for non-profit corporations,[50] although it has a separate form used by the Oklahoma Secretary of State. That form does not require the entity to avoid profits. Indeed, the concept would seem absurd: surely Oklahoma would permit a private school or hospital exempt under I.R.C. §501(c)(3) to make profits. Instead, the form provides:

> This corporation is not for profit, and as such the corporation does not afford pecuniary gain, incidentally or otherwise, to its members.[51]

Effectively, that language precludes what tax law

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[47] *E.g.*, Model Non-Profit Corp Act §6.01 (providing either for members or merely directors, which contrasts sharply with shareholder provisions for general business corporations); §6.40 (prohibiting distribution of earnings or assets to members). *See* IRS Publication 557 at 24 (2013) (permitting reliance on state law provisions permanently dedicating a charity's assets for exempt purposes).

[48] 15 Pa. Cons. Stat. Ann. §5101.

[49] The Pennsylvania Department of State's web site has two interesting provisions. One precludes private inurement. The other "suggests" that non-profit entities state their goal is to avoid "gain or profit, incident or otherwise." Nothing provides an enforcement mechanism for the suggestion. http://www.portal.state.pa.us/portal/server.pt/community/corporation_bureau/12457/pennsylvania_nonprofit_corporations/571889 (last visited 1/15/14).

[50] Okla. Stat. Ann. tit. 18 § 1002 (West 2014).

[51] Oklahoma Secretary of State Form 0009-07/12, available at https://www.sos.ok.gov/forms/FM0008.PDF.

would consider private inurement:[52] the passing of profits or earnings to members. But that language does not distinguish "for profit" from "non-profit."

Assuming the Third Circuit intended to distinguish between general business corporations and charities, that distinction illustrates an important surprising point: general business S corporations maintain a closer identity with owners than charities do with members. The close identity between the shareholders and the S corporation, like members' identity with a charitable organization, should be a crucial element on two levels: (1) deciding whether the S corporation, as a proxy for its shareholders, has standing to assert shareholders' religious rights; and (2) deciding whether the S corporation is truly an "artificial being" that is "distinct and separate" from its owners. Federal and state tax law, as well as state family law, explicitly or implicitly recognizes the identity of shareholders and their S corporation. That same recognition should be applied uniformly to decide standing to assert religious rights as well.

In sharp contrast with S corporations, charities are forbidden from having a close identity with founders and members.[53] The Third Circuit's use of the "for profit" versus "non profit" distinction was backwards. The court suggested "for profit" entities would have less identity with their founders and shareholders than would a "non-profit" entity like a charity. Under the law, a "non-profit" would not have

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[52] I.R.C. §501(c)(3).

[53] *E.g.*, I.R.C. §§501(c)(3) (prohibiting private inurement), 4958 (heavily taxing "excess benefit transactions" with "insiders"), and 4941 (heavily taxing "self-dealing").

the close identity. The S corporation would have the closer identity.

Shareholder-owned corporations exist to serve the purposes of the owners.[54] In contrast, charities exist to serve the purposes *as stated by* their creators.[55] They do not, however, *operate*[56] to serve the purposes of their members, officers, directors or even their founders. To do so would trigger problems with private inurement,[57] private benefit,[58] self-

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[54] *E.g.*, Model Bus. Corp. Act §3.01(stating the purpose of a corporation is for any lawful activity); §7.21 (2010) (providing for shareholder voting rights and thus control of corporate activities); §§7.40-7.47 (providing for shareholder derivative rights to assert, on their own, that which the corporation fails to assert); §14.01 (providing for distribution of assets to shareholders upon dissolution).

[55] Per I.R.C. §501(c)(3) charities must be "organized" exclusively to serve the charitable purposes stated in their creating documents.

[56] Per I.R.C. §501(c)(3) charities must "operate" exclusively for charitable purposes stated in their creating documents. Under the operational test, the charity's income and assets cannot inure to the benefit of its founders.

[57] I.R.C. §501(c)(3) requires "no part of the net earnings" inure "to the benefit of any private shareholder, or individual ." As applied, this means neither the earnings nor the assets may benefit founders or members in their capacity as founders and members. Such persons may be employees and may receive a reasonable salary, subject to strict rules in I.R.C. §4958.

[58] The private benefit doctrine is related to but distinct from the private inurement restriction. *See The Tax Law of Charities, supra note 44*, at 345-400.

dealing,[59] and excess benefit transactions.[60] From that perspective, what the Third Circuit called "for profit" corporations have a substantially greater identity with their owners than do what the Circuit apparently classified as "not-for-profit" entities, which, in most cases,[61] legally cannot have such an identity. That point directly relates to the important associational or representative standing issue here. The government appears to have no problem with "non-profit" entities using associational or relational standing on behalf of members; however, it objects to such standing by even closely held business corporations.[62] The analysis, however, should result in the opposite conclusion: S corporations such as

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[59] I.R.C. §4941 places a heavy excise tax on "self dealing" between a private foundation and a disqualified person, which generally includes substantial contributors, insiders, and members of their families, as well as any entities such persons own. The tax effectively forces private foundations to operate fully "distinct and separate" from their creators.

[60] I.R.C. §4958 imposes an excise on "excess benefit transactions" between a public charity and a disqualified person. The section 4958 definition of "disqualified person" differs dramatically from the section 4941 definition of "disqualified person." A disqualified person is an insider, a manager, or a person with "substantial influence."

[61] Unions, business leagues, social clubs, and veterans groups are exceptions.

[62] See Brief for Petitioners in No. 13-354 at 28, which recognizes that a partnership would have standing to assert associational standing on behalf of partners, while a corporation would not have standing on behalf of shareholders. The Brief does not acknowledge, however, that S corporations are far more like partnerships than they are like C corporations, and that the two types of corporation have radically different degrees of identity between entity and shareholders; *see also* Petition for Cert. in No. 13-354 at 23.

Hobby Lobby, Mardel, and Conestoga have much greater identity with their owners than do charities with their members.

The "for profit" terminology is unfortunate for another reason. The preposition "for" goes to the ultimate issue in this case: why these corporations exist. The government and the Third Circuit maintain they exist to make profits. Yet that conclusion presumes away the fundamental religious principles of the owners who claim they organize and operate their business "for" the glory of God.

Judge Garth, concurring in *Conestoga*, specifically rejected representative standing by emphasizing the separateness of the corporate entity:

> Conestoga further claims that it should be construed as holding the religious beliefs of its owners. This claim is belied by the fact that, as the District Court correctly noted, "[i]ncorporation's basic purpose is to create a distinct legal entity, with legal rights, obligations, powers, and privileges different from those of the natural individuals who created it, who own it, or whom it employs' . . . . It would be entirely inconsistent to allow the Hahns to enjoy the benefits of incorporation, while simultaneously piercing the corporate veil for the limited purpose of challenging these regulations."[63]

Judge Garth also rejected the petitioners' stated beliefs [64] that petitioners must operate their

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[63] Conestoga *Wood Specialties Corp. v. Sebelius*, 2013 U.S. App. LEXIS 2706, *13 (3d Cir. Feb. 7, 2013) Opinion/Order Re Expedited Motion for Injunction (Garth, J. concurring).

[64] Complaint at par. 27, *Conestoga v. Sebelius*, 917 F. Supp. 2d 394 (E.D. Pa. 2012)(No. 5:12-cv-06744-MSG) (stating petitioners'

corporation consistent with Mennonite teachings. The Judge stated: "[T]he purpose—and only purpose—of the plaintiff Conestoga is to make money!"[65] Judge Jordan, dissenting, took issue with the comment:

> That assumes the answer to the question the Hahns have posed. As a factual matter, it is unrebutted that Conestoga does not exist solely to make money. This is a closely held corporation which is operated to accomplish the specific vision of its deeply religious owners, and, while making money is part of that, it has been effectively conceded that they have a great deal more than profit on their minds. To say that religiously inclined people will have to forego their rights of conscience and focus solely on profit, if they choose to adopt a corporate form to conduct their business, is a controversial position and certainly not one already established in law.[66]

One must struggle to interpret what Judge Garth fully meant to say. On its face, the statement appears to flatly reject the owners' undisputed religious views that they operate the entity to fulfill their religious commandments. The reference to "money" along with the exclamation suggest a dichotomy reminiscent of the Biblical constraint that one cannot serve both God and money:

> No servant can serve two masters. Either he will hate the one and love the other, or he will be

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belief they must operate the corporation in line with their religious beliefs).

[65] *Conestoga*, 2013 U.S. App. LEXIS 2706, at *15 (Garth, J. concurring).

[66] *Id.* at *42-43 & n. 8 (Jordan, J. dissenting).

> devoted to the one and despise the other. You cannot serve both God and Money. *Luke* 16:13 (NIV).

The dichotomy raises serious theological issues. The stated views of the *Conestoga* petitioners, as well as those in *Hobby Lobby*, are more nuanced than how Judge Garth characterized them: to petitioners, one may – and indeed *must* – live one's whole life, including his commercial endeavors, for the glory of God. Making money does not equate to worshipping money and is not inconsistent with Christianity.[67]

Consider some traditional teachings:

- As obedient children, do not conform to the evil desires you had when you lived in ignorance. But just as He who called you is holy, so be holy in *all you do*. 1 *Peter* 1:14-15 (NIV) (emphasis added).
- Give your *whole life* and body to God. *Romans* 12:1,2 (NIV) (emphasis added).
- Love the Lord your God with all your heart and with all your soul and with all your mind. *Matthew* 22:37 (NIV).
- *Whatever you do*, work at it with all your heart, as working for the Lord, not for human masters. *Colossians* 3:23 (NIV) (emphasis added).
- So whether you eat or drink or *whatever you do*, *do it all* for the glory of God. 1 *Corinthians* 10:31 (NIV) (emphasis added).
- Then the LORD said to Moses, "See, I have chosen Bezalel son of Uri, the son of Hur, of the

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[67] *See* Jay W. Richards, *Money, Greed and God: Why Capitalism is the Solution and not the Problem* 3-5, 7-8, 119-133 (2009) (analyzing the Christian Biblical basis for economic prosperity).

> tribe of Judah, and I have filled him with the Spirit of God, with skill, ability and knowledge in all kinds of crafts--to make artistic designs for work in gold, silver and bronze, to cut and set stones, to work in wood, and to engage in all kinds of craftsmanship. *Exodus* 31:1-6 (NIV).

God did not call people to be holy merely in Church, Synagogue, Temple, Mosque or while on a mission. He made a commandment for one's whole life: while at work, at play, walking the dog, buying groceries, or investing talents. God did not mention a commercial, let alone a corporate exception, as in "Act according to my law, unless you create a corporation or enter business."

Judge Garth's statement goes to the heart of the religious issues. It creates the appearance that he believes earning money is not itself consistent with the practice of Christianity. If this Court ultimately limits religious freedom to non-commercial activities, it will force many people to choose between practicing their faith and entering commerce, particularly as business operators. If it permits religious freedom only for "religious" commercial activities, it inevitably must define "religious," potentially, as did Judge Garth, in a manner inconsistent with fundamental theology of one's whole life being for the glory of God.

This Court may, in the alternative, limit religious rights based on the entity rather than the activity. In so doing, it may, as did the Third Circuit, deny religious rights to corporations, or to some class of corporation. If it does so with a broad brush, it will tell many religious people "You cannot incorporate your family business and still practice your religion."

Perhaps the Court will permit religious rights in the commercial operation of sole proprietorships, general partnerships, or simple trusts.[68] Wherever this Court draws the line, however, it will inevitably affect "choice of entity" planning for tax and corporate lawyers.[69] Advisors will have to counsel clients they may give up religious rights if they choose some business entities but not if they choose another. Thus the Court should be very careful to consider exactly where to draw that line.

Drawing the line with S corporations on one side having religious rights and C corporations on the other, with no religious rights, is an option worth serious consideration. C corporations are truly separate entities from shareholders. Whether C corporations have their own religious rights is not before the Court. Prudential and associational standing, however, *is* before the Court. C corporations lack a close relationship with shareholders. A holder of shares in a C corporation is sufficiently removed from the corporation's operations that no serious theological issues arise to tar shareholders with corporate actions. But, the religious rights of C corporations is not before the Court.

S corporate shareholders, in contrast, are so intimately involved with and related to their corporation, the theology is clear for many: what the corporation does, they do as well. Using the

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[68] I.R.C. §641(b). A simple trust is a pass through entity under I.R.C. §1(h)(10)(E); in contrast, "complex trusts" are taxpayers under I.R.C. §651. *See Willis*, *supra* note 4 at 70-77 (discussing how the *Hobby Lobby* and *Conestoga* litigation might view various commercial entities).

[69] *Id.*

preposition "for" as used by the Third Circuit, the S corporation exists and acts "for" the shareholders. Because the law—federal and state tax law, as well as much family law—treats S corporate shareholders as the real actors in whatever business the S corporation conducts, the religious rights of the shareholders are very relevant. Thus S status should be an important factor in the Court's drawing of lines concerning which type of entity may assert religious rights on its own or on behalf of its owners.

CONCLUSION

This brief demonstrates two fundamental errors in the Third Circuit opinion:

1. The Third Circuit erroneously lumped all corporations together by describing them as "distinct and separate" from their owners and as "artificial beings." The court ignored the S corporation status of the litigants. Federal and state tax law, as well as much of family law, treats Conestoga, as well as Hobby Lobby and Mardel, all of them S corporations, as one and the same with their owners. Tax and family law typically ignore an S corporation's separate entity status and treat the shareholders as the true actors. This Court should distinguish S corporations from C corporations. It should recognize the actions of Hobby Lobby, Mardel, and Conestoga as the actions of the shareholders and should thus respect the religious rights of the entities as well as the right of the entities to assert the rights of the shareholders.
2. The Third Circuit confusingly used the term "for profit" in attempting to distinguish "for profit"

entities from "non profit" entities. If this Court draws such a distinction, it should either clearly define those colloquial terms or, better, it should carefully use tax and corporate terms of art to draw distinctions. Also, by describing Conestoga as a "for profit" entity, the Third Circuit presumed the ultimate fact regarding why the entity exists. This Court should be careful not to make the same mistake.

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